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No. 89-5

In The

Supreme Court of the United States

October Term, 1988

RICHARD D. ELLENBERG as Trustee in Bankruptcy for Rodger and Rodger, Inc.,

Petitioner,

v.

T & B SCOTTDALE CONTRACTORS, INC.,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

C. DAVID HAILEY*
SWIFT, CURRIE, MCGHEE & HIERS
The Peachtree
1355 Peachtree Street, N.E.
Atlanta, Georgia 30309-0300
(404) 874-8800

* Counsel of Record

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OR CALL COLLECT (402) 342-2831

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QUESTIONS PRESENTED

Whether the funds deposited into a special bank account are property of the estate within the meaning of 11 U.S.C. § 541.

If the funds deposited into a special bank account are not property of the estate within the meaning of 11 U.S.C. § 541, can the trustee bring the funds into the estate pursuant to 11 U.S.C. § 544(a)(1).

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T & B SCOTTDALE CONTRACTORS, INC.,[1]

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I. STATEMENT OF THE CASE

On June 6, 1982, T & B Scottdale Contractors, Inc. (hereinafter "T & B"), entered into a construction contract with the City of Atlanta (hereinafter "Atlanta Contract") for construction of a particular project. To facilitate participation by minority contractors, the Atlanta Contract authorized T & B to develop procedures which permitted minority subcontractors to participate in the project without the necessity of obtaining separate surety bonds. One

[1] There are no parent, subsidiary or affiliated corporations.

such procedure specifically contemplated and authorized by the Atlanta Contract was the purchase of materials by use of a joint checking account.

Rodger & Rodger, Inc. (hereinafter "R & R"), was approved by the City of Atlanta as a minority subcontractor and was awarded the mechanical portion of the construction project. T & B, as the prime contractor, and R & R, as the subcontractor, entered into a working agreement regarding the handling of a joint checking account (hereinafter "Account"). The Account was needed for the purpose of paying R & R's suppliers, thereby avoiding the need for R & R to furnish a surety bond. This working agreement provided in pertinent part as follows:

> With respect to Item 3 above, Contractor shall purchase and pay for equipment in Subcontractor's name in accordance with terms and conditions dictated by Contractor. Contractor shall open a bank account in Subcontractor's name for the sole purpose of paying for equipment covered by Item 3 above. Contractor shall maintain control of such bank account but account shall be set up joint signature by Contractor and Subcontractor.

When this working agreement was entered into, R & R was fully aware of and agreed to the fact that T & B was to maintain control over the Account and that any funds deposited into the Account were funds of T & B to be used solely for the purchase of equipment. No funds from the Account were to be used to pay R & R for its performance of the contract. Moreover, none of the funds deposited into the Account were ever paid to R & R for its performance of the contract.

During the time that the Account was opened, it was handled in a manner consistent with the working agreement. When R & R ordered equipment for the project, and received an invoice for said equipment, R & R would forward the invoice to T & B. T & B would then deposit sufficient funds in the Account to cover the cost of the equipment, prepare a check, have R & R co-sign the check and then forward same to the equipment vendor for payment. As a result, the balance in the Account was typically zero.

The Account was opened by Mike Samford, an officer of T & B, at Trust Company Bank (hereinafter "Trust Company"), T & B's bank in Atlanta, Georgia. Mr. Samford instructed Trust Company that any checks on the Account had to be signed by one of two designated representatives of T & B, along with a designated representative of R & R. Trust Company agreed to mail the account statements, along with any other mail relevant to the Account, to T & B, rather than R & R. Shortly after the Account was opened, Trust Company agreed to discontinue assessing service charges against the Account because of compensating balances maintained by T & B in other accounts at Trust Company.

II. SUMMARY OF ARGUMENT

Because of the limited purpose for the Account, the manner in which the Account was opened, the way in which the Account was handled, and the source of the funds deposited into the Account, R & R had no interest in the Account under Georgia law. Under 11 U.S.C. § 541,

the court must look to Georgia law to determine the ownership of the Account. Because R & R had no ownership interest in the Account, the Trustee has no claim to the funds under 11 U.S.C. § 541.

Similarly, Georgia law governs the rights of the Trustee to recover property under 11 U.S.C. § 544(a)(1). The Trustee, as a judicial lien creditor, has no right to recover the funds in the Account under Georgia law because of the special nature of the Account, its limited purpose, and the manner in which it was opened and maintained.

III. REASONS FOR NOT GRANTING THE WRIT

A. UNDER THE UNIQUE FACTS IN THIS CASE, PARTICULARLY THE SPECIAL NATURE AND LIMITED PURPOSE OF THE ACCOUNT, THE ELEVENTH CIRCUIT'S DECISION WAS CORRECT AND CONSISTENT WITH OTHER CASE AUTHORITY

1. The Eleventh Circuit's Decision Was Correct Under 11 U.S.C. § 541.

As noted by the Eleventh Circuit, the question of what interest R & R, and thus the Trustee had in the account is to be determined by state law. *In re Livingston*, 804 F.2d 1219 (11th Cir. 1986). Under Georgia law it is clear that R & R has no interest in the Account. This is so because of the special nature and limited purpose of the Account. The funds were deposited for the sole purpose of paying the equipment vendors. Both the working agreement and the bank documentation generated when the Account was opened established that T & B opened

the Account, received all account statements, and maintained control over the Account. The Account balance was generally zero and monies were deposited only when needed to pay equipment vendors. T & B made all deposits to the account. R & R did not receive any funds from the Account, was never entitled to receive any funds from the Account, and made no deposits into the Account.

Under Georgia law, when money is deposited into an account for a special purpose known to the parties, and the money remains segregated, title remains in the depositor until the money is used for that purpose. Such deposits, particularly when they are made in accounts to pay vendors, are considered special deposits with title remaining in the person making the deposit, in this case T & B. *Jasper School District v. Pickens County*, 187 Ga. 433, 200 S.E. 780 (1939); *Manget v. National City Bank*, 168 Ga. 876, 149 S.E. 213 (1929). Accordingly, the decision by the Eleventh Circuit is consistent with Georgia law regarding special bank accounts of this nature and the Trustee has no interest in the account.

Petitioner has referred this Court to several cases in an effort to show that the reasoning by the Eleventh Circuit is either flawed or inconsistent with other opinions. The Petitioner's arguments in this regard are inaccurate. All of these cases, and others not cited by Petitioner, are consistent with the Eleventh Circuit's opinion.

The Lottawanna, 88 U.S. (21 Wall) 558 (1874), and *United States v. Speers*, 382 U.S. 266 (1965), both involved the question of whether unrecorded liens, as of the date of the filing of the bankruptcy, should have priority over

other creditors. These cases were not decided under Georgia law and were not concerned with a special bank account of this nature, into which funds were segregated and held for a specific purpose.

Petitioner cites to a number of cases where the courts held that a debtor/creditor relationship existed, rather than a trust relationship, because funds held or being collected by the debtor were not placed in a special account or segregated, so as to retain their character as trust funds. Contrary to Petitioner's argument, these cases actually support T & B's position and the opinion by the Eleventh Circuit.

The primary case upon which Petitioner places reliance is *Georgia-Pacific Corp. v. Sigma Services Corp.*, 712 F.2d 962 (5th Cir. 1983). Contrary to Petitioner's assertions, the *Sigma* court, by its own admission, addressed the joint check arrangement without the benefit of the transcript of evidence taken during the hearing on that particular issue. *Id.* at 971. The only documentary evidence in the record was a letter written by Sigma indicating that Georgia-Pacific could make the checks payable to Sigma and Sigma's suppliers for the amount shown on the invoices. However, there was an absence of any evidence that actions were taken in reliance on this letter or that other consideration made the letter binding on Sigma. The *Sigma* court specifically noted that the naked wording in the letter merely represented Sigma's unilateral agreement to have some of the proceeds due to Sigma made payable to it by joint checks. In particular, the *Sigma* court noted that the agreement placed no affirmative duties upon Sigma in relation to the suppliers. Accordingly, the court was unable to find from the letter

agreement itself that Sigma and Georgia-Pacific had mutually agreed that Sigma's suppliers should receive any nonrevocable property interest in the funds due by Georgia-Pacific to Sigma.

In so holding, the Fifth Circuit in *Sigma* distinguished several joint check-constructive trust decisions which support T & B's position. In *Kenan Pipe & Supply Co. v. Shield*, 241 F.2d 486, 489-90 (9th Cir. 1956); *Mullins v. Noland Co.*, 406 F. Supp. 206, 210 (N.D. Ga. 1975); and *Limperas v. Material Service Corp.*, 415 F. Supp. 65 (N.D. Ill. 1976), the courts found a constructive trust arising from a joint check agreement to pay vendors.

Accordingly, the Eleventh Circuit was correct in relying on *Sigma* if the evidence reflected the existence of a joint check agreement or a special checking account agreement which imposes specific duties with regard to the control of the account and the payment of vendors. In such instances, the property is not to be considered property of the estate.

The decision by the Eleventh Circuit is also consistent with the Fifth Circuit's decision in *South Central Livestock v. Security State Bank*, 551 F.2d 1346, *aff'd after remand*, 614 F.2d 1056 (5th Cir. 1980). In *South Central Livestock*, the depositor, a cattle feed lot operator, came into possession of monies as cattle belonging to others were sold. The money was deposited into accounts set up for this specific purpose. The money was segregated from the general funds of the feed lot operator until it could be transmitted to the owners of the cattle. The court found that such an account was a special account, subject to a trust, thereby defeating the claims of the bank asserting a

right of offset. *Id.* at 1350. Moreover, when the case was on appeal for the second time, the Fifth Circuit ruled that the trustee in bankruptcy for the feed lot had no ownership interest and could assert no claim to the funds in the account. 614 F.2d at 1061.

The Petitioner also refers this Court to *In re Auto-Train Corp.*, 810 F.2d 270 (D.C. Cir. 1987), as supporting authority. The *Auto-Train* case involved a situation where the debtor was a middleman in the purchase of railroad cars. The ultimate purchaser of the cars paid Railway, and then, over a period of several weeks, Railway paid the manufacturer. The trustee attacked the transfer of funds to the manufacturer as a preference. There was no segregation of the funds and Railway used the funds for general operating purposes, thereafter paying the manufacturer out of its general revenues. The Court, under those facts, held that nothing more than a debtor-creditor relationship existed.

However, in so holding the *Auto-Train* court expressly noted that the opposite outcome was justified in a number of other cases, particularly where the funds were segregated from the debtor's own funds and held for a specific purpose. *Id.* at 274. It is also important to note that the debtor in *Auto-Train* did not open a special bank account for purposes of depositing the funds and remitting same to the manufacturer, although such an account was requested and discussed when the transaction was in the negotiation stage. *Id.* at 274. Thus, while the court in *Auto-Train* did not specifically address the question of what impact a special account would have had on its decision, it is clear from the court's reasoning

that the existence of a special account would have lead to the court to reject the trustee's claim.

In re Black & Geddes, Inc., 35 B.R. 830 (Bankr. S.D.N.Y. 1984), and *In re Penn-Dixie Steel Corp.*, 6 B.R. 817 (Bankr. S.D.N.Y. 1980), involved situations similar to that in *Auto-Train*. In *Black & Geddes* the debtor was middleman for purposes of arranging shipments of ocean cargo. The debtor either received or was to receive payment for the shipping charges but did not remit those charges to the carrier. The court, in rejecting the constructive trust theory, specifically noted that there was no obligation to keep the funds segregated and that the funds, when received by the debtor, were used as general operating funds. *Id.* at 833. *Penn-Dixie Steel* also involved the failure by the debtor to remit freight charges to the carrier. Again, the court noted that the funds received by the debtor were deposited into its general bank account. The court further noted that there was no agreement to segregate the funds or even a request for segregation of any portion of the funds. In fact, it is clear from a thorough reading of the *Penn-Dixie* opinion that the outcome would have been different had there been an agreement to keep the funds segregated in a special account with duties imposed upon the debtor as to the distribution of those funds. *Id.* at 825.

Carlson v. Commercial Discount Corp., 382 F.2d 903 (10th Cir. 1967), another case relied upon by the Petitioner, is also distinguishable because of the failure on the part of the debtor to segregate the funds in question. The *Carlson* case involved a claim by the debtor's lessee to the lessor's sales receipts, based upon some trust language in the lease. The court in *Carlson* rejected the trust theory

since the lessee knew that the debtor was commingling the sales receipts with other funds and had unrestricted use of the monies for the day-to-day operation of the lessor's business.

In re Bass Mechanical Contractors, Inc., 84 B.R. 1009 (Bankr. W.D. Ark. 1988), is similarly distinguishable. The court refused to impose a constructive trust upon funds that were paid to a subcontractor, in the absence of an agreement that those funds were to be used solely for the payment of vendors, and under circumstances where the subcontractor had refused to enter into an agreement limiting its use of the funds or to agree to a joint check or special account arrangement.

The Eleventh Circuit's opinion is also consistent with two *Penn Central* companion cases, which were not referred to by Petitioner. A comparison of these two cases provides an interesting illustration of the application of 11 U.S.C. § 541 where money is held by the debtor for another. In *In re Penn Central Transportation Co.*, 328 F. Supp. 1278 (E.D. Pa. 1971), the insolvent railroad company collected money for Greyhound and deposited the money into its general bank account, as allowed under an agreement between the parties. Greyhound had no control over the account and the funds were commingled with Penn Central's general funds. Under those facts, the court refused to impose a trust. However, in the companion case, the same court imposed a constructive trust on funds deposited into a special account for the intended purpose of meeting the railroad's interest obligations on its bonds. *In re Penn Central Transportation Co.*, 328 F. Supp. 1279 (E.D. Pa. 1971).

Accordingly, the decision by the Eleventh Circuit is consistent with decisions by bankruptcy courts, district courts, and by other circuit courts of appeal. Moreover, the Eleventh Circuit opinion is consistent with this Court's decision in *McKey v. Paradise*, 209 U.S. 119 (1936), another case relied upon by the Petitioner. In *McKey*, this Court specifically noted, in ruling in favor the trustee, that "at no time did the bankrupt segregate any money . . . or deposit any money in any separate trust account or bank account." *Id.* at 120-121.

The Eleventh Circuit, in the case at hand, simply acknowledged that there is a distinction between instances where funds are received by the debtor, for a specific purpose, and instances where funds are allowed to be deposited into the general account of the debtor and used as part of the debtor's general operating funds. The Eleventh Circuit's opinion is consistent with those cases which allow the Trustee to recover funds which are commingled with the debtor's general funds. The Eleventh Circuit's opinion is also consistent with those cases which recognize that a constructive trust or ownership interest arises where those funds are deposited into a special account and segregated from the general operating funds of the debtor. The Eleventh Circuit's opinion is also consistent with the legislative history of 11 U.S.C. § 541, wherein Congress noted that funds held by the debtor for the benefit of another are not part of the estate. H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977); Sen. Rep. No. 989, 95th Cong., 2d Sess., 82, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5868, 6324.

Petitioner seeks to create a conflict among the authorities by ignoring the special nature of the Account opened

by T & B, the manner in which the Account was handled and the very specific, limited purpose for the Account. Moreover, Petitioner attempts to promote this conflict by ignoring language in those cases which indicates that those courts would have ruled the same way that the Eleventh Circuit ruled in this case, had those cases involved similar facts.

As noted by the Eleventh Circuit, it is undisputed in this case that the funds deposited in the Account were not meant for R & R. The Petitioner has not cited this Court to a single case that either holds or implies that R & R would have any right or interest in the funds. If the funds in the Account were brought into the estate it would be a windfall for the other creditors, who would then benefit from funds that were never to have been paid to R & R. 11 U.S.C. § 541 simply cannot be used to expand the bankrupt's rights in property beyond those in existence at the time the bankruptcy petition was filed. 4 Collier on Bankruptcy, § 541.01 at 541-46.

2. The Eleventh Circuit's Opinion Does Not Undermine The Trustee's Strong Arm Power Or Conflict With The Ninth Circuit's Opinion In *In Re Tleel*

Petitioner also argues that the Trustee should be able to bring the Account into the estate pursuant to 11 U.S.C. § 544(a)(1), which places the Trustee in the position of a judicial lien creditor. However, Petitioner was unable to provide either the Eleventh Circuit or this Court with any Georgia law which supported his argument that a judicial lien creditor would have a claim to the Account superior to the claim of T & B.

Petitioner cites to two Georgia cases in support of his argument. *General Lithographing Co. v. Sight & Sound Projectors, Inc.*, 128 Ga. App. 304, 196 S.E.2d 479 (1973); *In re National Buy-Rite, Inc.*, 6 B.R. 102 (Bankr. N.D. Ga. 1980). Neither case supports the Trustee's position. First, neither case is a decision by the Georgia Supreme Court, which is the highest appellate court in this state. Secondly, neither case involves a special bank account. *General Lithographing* addresses the question of whether a garnishment takes priority over an unrecorded security interest under Georgia law, a situation that is not presented by the facts in this case. *National Buy-Rite* addresses the question of whether a lien creditor has priority over an unperfected security interest, which again is not the situation in this case. In contrast, Respondent T & B has provided this Court with two cases by the Georgia Supreme Court which specifically hold that title and ownership to a special account of this nature remains in the person making the deposit to the account. *Jasper School District v. Pickens County, supra; Manget v. National City Bank of Rome, supra.*

Moreover, this case is similar to and consistent with the earlier Eleventh Circuit decision in *In re General Coffee Corp.*, 828 F.2d 699 (11th Cir. 1987), *cert. denied*, ___ U.S. ___, 108 S.Ct. 1407 (1988). In *General Coffee* the Eleventh Circuit found, because of fraud perpetrated on the party claiming certain property, that the property was held in trust and thus did not become part of the estate under 11 U.S.C. § 541. Similarly, the Eleventh Circuit found that the Trustee, as a judgment lien creditor under 11 U.S.C. § 544(a)(1), could not claim the property under applicable state law. In both this case and the *General Coffee* case, the

Eleventh Circuit did not have to reach the question of whether 11 U.S.C. § 541 overrides 11 U.S.C. § 544, because the Trustee's claim failed under either section.

The Trustee also cites to *Sampsell v. Straub*, 194 F.2d 228 (9th Cir. 1951), for support. The *Sampsell* case involved California law concerning the trustee's attempts to avoid a homestead exemption which was not filed until after the bankruptcy petition. It is not even remotely similar to this case.

Matter of Quality Holstein Leasing, 752 F.2d 1009 (5th Cir. 1985); and *In re Executive Growth Investments, Inc.*, 40 B.R. 417 (Bankr. C.D. Cal. 1984), involved the trustees' claims as against unperfected security interests. Such cases have no applicability to special bank accounts of the type involved in this case.

In re Tleel, 79 B.R. 883 (9th Cir. 1987) (respondent was unable to find a more recent decision in this case); *Matter of Plunkett*, 89 B.R. 776 (Bankr. E.D. Wis. 1988); and *Matter of Elin*, 20 B.R. 1012 (Bankr. D. N.J. 1982), *aff'd mem. sub nom, Elin v. Busche*, 707 F.2d 1400 (3rd Cir. 1983), involved the trustees' attempts, under applicable state law, to recover certain interests in real property pursuant to 11 U.S.C. § 544(a)(3), by virtue of the trustee's position as a bona fide purchaser for value. These cases have no applicability to a special bank account of this nature and certainly are not persuasive authority under Georgia law.

IV. CONCLUSION

Respondent respectfully requests that the Trustee's petition for writ of certiorari be denied. In essence, this case involves a unique set of facts regarding a special bank account and the parties' rights in that account under Georgia law. The Eleventh Circuit found, under Georgia law, that the Trustee was not entitled to recover the property under either 11 U.S.C. § 541 or 11 U.S.C. § 544. This case does not present a conflict between these two Code sections for resolution by this Court because the outcome is the same under either section. Moreover, the Eleventh Circuit's decision is consistent with, as opposed to in conflict with, prior decisions by this Court, by other circuit courts of appeal, and by the Georgia Supreme Court.

Respectfully submitted,

C. David Hailey
Swift, Currie, McGhee & Hiers
The Peachtree
1355 Peachtree Street, N.E.
Atlanta, Georgia 30309-0300
(404) 874-8800

Attorneys for Respondent
T & B Scottdale Contractors, Inc.